# UNITED STATES OF AMERICA BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION

PREPARED	REMARKS OF MELISSA I ON BEHALF OF THE	BROWN
Request for Technical Conference Petition for Rulemaking	and )	<b>Docket No. AD20-6-000</b>
RTO/ISO Credit Principles and P	ractices )	<b>Docket No. AD21-6-000</b>

# Panel 2: RTO/ISO Comparison of Risk Management Structure, Credit Enhancements and Lessons Learned

My name is Melissa Brown, and I am the Senior Vice President and Chief Financial Officer of the Midcontinent Independent System Operator, or MISO. As the first Commission created RTO, MISO is proud to serve over 15 states ranging from Louisiana to Minnesota, Manitoba, our many stakeholders, and the over 40 million end use customers who rely on our daily reliability and value creation. Particularly in times of stress on the electric grid, such as those we have experienced recently, we are proud of our mission and its execution. As such MISO is pleased to participate in this technical conference, and particularly this panel, to share our risk management structure, credit enhancements, and lessons learned.

MISO also appreciates the Commission for entrusting us to manage credit risk on behalf of our members. It is a task we have taken extremely seriously, looking to industry best practices and working with stakeholders to design credit safeguards that have prevented MISO from having any serious default throughout its history. MISO believes our historical market default performance demonstrates our dedication to the fiduciary responsibility we are entrusted with by our members, with the largest market default to date totaling \$1,000, which occurred in 2015.

To ensure market functions and avoid market defaults, first and foremost, a market must be reliable and well designed to appropriately support efficient and adequate electricity supply. Credit is used as a mechanism to help ensure participants in the market are able to meet their financial obligations to the market. While credit provides assurances "normal" activity will be settled, credit cannot guarantee market settlement nor account for every event that can occur in a market, such as theextreme events we saw only last week in Texas.

#### Reliable Market

From a 50,000-foot perspective, the Commission's electricity and related markets are built on top of a robust transmission grid and electric supply, i.e. our power system. The more reliable and resilient the power system is, the less a chance that wild price swings will produce

defaults. A reliable and resilient power system is the most basic, and most fundamental, way to minimize defaults. The Commission has a great deal on its plate, but in some ways, to better protect credit policy and reduce defaults, the surest way is to enhance the bulk power system's reliability and resilience through robust transmission infrastructure and inter-regional connectivity. Recent events in ERCOT, SPP, and even MISO clearly underscore this point.

# Market Design

After that, market design and awareness is key. As I will stress throughout MISO's presentation, good credit policy follows the markets, and if the market design is poor, even the best credit practice will not prevent defaults. MISO is actively looking at these issues as part of its Reliability Imperative Effort. Two key elements of this effort include robust long-term transmission planning and efforts to continue to redefine market tools to meet the evolving needs.

#### **Credit Practices**

Reliable power systems and market design must be supported by sound credit practices, encompassing both policy and management. The key to a good credit policy is ensuring sufficient collateral is posted for any positions a market participant may take. Shortcuts, such as allowing past FTR revenues to offset the collateral posted, when transmission congestion can and does shift over time, should be removed. Second, credit policies should ensure that, separate from collateral, there is sufficient capitalization should those positions go outside of the "normal" pricing ranges. The Commission has a statutory mission to not be "unduly discriminatory or preferential," which MISO respects and applauds. But if market participants are to be paid for removing risk from other market participants, they should have sufficient capitalization behind their collateral to cover that risk when it comes due.

Because MISO believes good credit practices and policies must be tied to markets that are constantly evolving, credit practices and policies must be able to keep up. This involves discretion and judgment. MISO's credit practices are predicated on emphasizing experience and knowledge of those that manage credit risk. Between my Director, Credit Manage, and myself, we have nearly 75 years of credit experience, and our four analysts have an average of 13 years experience. There is no substitute for experienced people with good judgment watching the credit of an RTOs members. MISO actively monitors and oversees credit margins with effective processes and a compliance driven culture, timely action to address any risks, and open communication with appropriate escalation and responses. What we have found over time is this the fluid nature of credit monitoring and market movements, effective credit practices can never be a check the box exercise.

#### Credit Enhancements and Stakeholder Processes

Overall, MISO is confident we have the right credit protections in place, however as in all matters, there are potential areas for improvement. One area is addressing extreme price volatility tied to events that are disruptive to the power grid and its markets. Even before GreenHat became part of the industry lexicon, MISO began reevaluating our credit safeguards. And along with other RTOs, we filed reforms to our credit protections in late 2019, including adding mark-to-auction and minimum collateral standards to our FTR market.

Then in early 2020, after significant stakeholder engagement, the Commission granted us reforms that gave us broad authority to address any unreasonable credit risk, subject to

Commission oversight, and to prevent a market participant with an uncured market default from reentering our market under a different corporate form. Those of us at MISO believe it is a measure of the trust we have earned from our stakeholders and the consensus we built through our discussions that neither the 2019 nor 2020 filings drew a single protest from our stakeholders in the proceedings at the Commission.

MISO notes that since late 2019 and early 2020, MISO and other RTOs lack a long track record of the effectiveness of recent changes. More time is likely necessary to evaluate the full value of these adjustments. But I would like to share MISO's viewpoint based on our experienced staff, stakeholder discussions, and solid track record of protecting our stakeholders' credit.

First, stakeholder involvement is key. Credit policy should be made with the approval and involvement of the stakeholders using that market. In the wake of GreenHat, MISO decided to make two updates quickly: a minimum collateral requirement and a mark-to-auction requirement. We viewed this as good stewardship. After these updates were in place, however, we engaged in an open dialogue with our stakeholders interested in further credit policy reforms. And some of the contours of that discussion are relevant and very informative in this context.

MISO began by proposing a number of transparent, prescriptive rules that sought to define MISO's credit requirements and responses to each potential event, drawing thresholds for different classifications of risk. MISO proposed that MP who may have been involved in risky credit activities could be considered bad actors and tracked and treated differently. We proposed tying increased credit requirements to entities that were alleged or settled charges of market manipulation brought by the Commission. We considered imposing trading bans on certain actors and entities. And after many months of dialogue, each one of those proposals was questioned and generally dismissed by the stakeholders. Some felt to use Orders to Show Cause for Market Manipulation as a ground for increased credit requirements was deemed to violate due process. Others felt the tracking of individuals was too burdensome. No market participant wanted to contemplate MISO imposing a trading ban.

After our extensive dialogue with stakeholders, MISO walked away with a key lesson: ask for the flexibility and authority, with Commission oversight, to take defined measures in the face of an unreasonable credit risk. These tools include increased collateral, reduced positions, or suspension of trading. Akin to the Commission's authority on market manipulation, rather than create rules seeking to anticipate and second guess the next fast moving credit risk, MISO asked and received authority to address it immediately, and put MISO's rationale in writing for Commission oversight and subsequent proceedings to be tested after the fact.

MISO believes this experience serves a successful guide as the Commission evaluates credit policy processes across RTOs. Discretion, combined with stakeholder acceptance, is necessary, and key to good credit protections.

One area MISO is just beginning to evaluate for potential enhancement is the minimum capitalization requirement. Capitalization demonstrates a MP has the financial wherewithal to meet their financial obligation to the market even in the event of significant price volatility. MISO currently has a \$50,000 minimum capitalization requirement which is low compared to pricing events we have seen over the past two years. MISO is beginning to evaluate if the minimum capitalization should be modified to consider extreme price volatility.

### Regional Market Design Differences

Each RTO has different market structures and products. Those differences stem not only from regional differences and underlying state laws and utility structures, but from the preferences of an RTOs stakeholders. MISO is ultimately a voluntary organization. And, within the bounds of what the Commission determines as just and reasonable, it behooves us to have market structures that are responsive to those that belong and participate in MISO. The same goes for credit practices. Good credit practices must be applied within the context of the market itself. For example, collateral that is appropriate for a three year forward FTR market is not the same as collateral in a one-year FTR market. Hence, sweeping collateral reductions in the name of uniformity across all markets could unnecessarily increase risk. Conversely, sweeping collateral increases could drive out market participants and the accompanying liquidity that comes with them.

Effective credit policies and protections follow the market, not the other way around. So if the Commission is considering imposing a requirement or a standardization across RTOs, please make sure it is grounded in an actual improvement in credit protections for all of the markets as they exist. It is one thing to have the RTOs collaborate on intake forms, allowing potential participants to file one form instead of six. It is much riskier to impose standard collateral requirements across different markets and products.

## **Information Sharing**

The Commission has asked its panelists to look into potential information sharing. MISO believes that this could be helpful, provided the information exchanged can coexist with valid confidentiality concerns of market participants *and* that the additional information is factual and actionable to address credit risk. For instance, knowing which RTOs a given company participates in might be helpful if there happens to be an extreme event or dislocation in that market. But as noted earlier, credit risk is often a function of extreme events—hurricanes, unprecedented cold weather—and the market positions taken.

The critical question in information sharing is how to share and aggregate it. All RTOs having the credit information of all other RTOs not only seems inefficient and burdensome, but the potential inadvertent release of that information, if not very carefully managed through safeguards, may increase sixfold. Liability for such potential inadvertent disclosures should also be considered and addressed.

The Commission has looked at sharing market data and position information among and between RTOs before. If information sharing does occur, it would make sense for there to be a single, central depository of that information, with limited access and distribution. The Commission would be one such candidate for this sort of information sharing, echoing Order 760 data. Another alternative would be encouraging greater coordination and sharing among IMMs or other structures could be created. One alternative structure which is already in place is that RTO credit teams participate in monthly calls to share information and perspectives on best practices, potential improvements and lessons learned.

Simply relaxing confidentiality provisions to allow RTOs to share credit information is unlikely to significantly reduce credit risk, creates additional burdens to be passed along to stakeholders, and creates additional risks, such as an increased risk of disclosure, in the process.

#### Conclusion

In closing, we need to make sure that RTOs are successfully meeting the needs of customers by balancing the benefits of market liquidity with protecting customers from the undue costs created by financial failures of market participants. MISO filed a little over a year ago with the Commission to continue to strengthen its rules, as did numerous other RTOs. As the Commission undertakes its review of RTO credit policies, it should guard against letting one very specific and unusual event, or extremes of price separation causing an occasional default, provoke a series of reforms that limit regional flexibility to serve their customers. The Commission should encourage the RTOs to continue robust collaboration to identify best practices and continue to encourage accountability among the RTO management with active stakeholder engagement. To the extent a stakeholder finds that the stakeholder process is not resulting in needed reforms, they have an opportunity to raise the issue to the Commission through the compliance process. It is MISO's experience that responsibility for credit policies are best managed through individual RTO processes rather than standardized rules that potentially shift the responsibility for effective credit practices from the RTOs themselves to generic Commission rulemakings. Given the fluid nature of credit monitoring and market movements, we believe effective credit practices can never be a check the box exercise.

Respectfully submitted,

/s/ Melissa Brown

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